

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
MAUI ELECTRIC COMPANY, LIMITED)
For Approval of Second Amendment to)
Supply Contract for No. 2 Diesel)
Fuel for Lanai Oil Company, Inc.)
And to Include Contract Costs in)
Maui Electric Company, Limited's)
Energy Cost Adjustment Clause)

DOCKET NO. 2007-0072

DECISION AND ORDER NO. 23829

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DIV. OF CONSUMER ADVOCACY
DEPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

Filed Nov. 13, 2007
At 1 o'clock P.M.

Karen Higashi
Chief Clerk of the Commission

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.

Karen Higashi

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Maui Electric Company, Limited's)

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DECISION AND ORDER

By this Decision and Order, the commission approves MAUI ELECTRIC COMPANY, LIMITED'S ("MECO") application, filed on March 20, 2007 ("Application"), for approval of the Second Amendment to Supply Contract for No. 2 Diesel Fuel ("Second Amendment").¹ The commission further approves MECO's request to include the costs of No. 2 Diesel Fuel ("Fuel") and related taxes in MECO's Energy Cost Adjustment Clause ("ECAC") to the extent that the costs are not recovered in MECO's base rates.

¹MECO served copies of its Application on the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"), an ex officio party to this docket, pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62. MECO and the Consumer Advocate are the only Parties to this docket.

I.

Background

A.

Application

MECO is an operating public utility engaged in the production, purchase, transmission, distribution, and sale of electricity on the islands of Maui, Lanai, and Molokai, Hawaii.

On March 20, 2007, MECO filed its Application, requesting the commission to approve the Second Amendment, which amends, in part, MECO's Supply Contract for No. 2 Diesel Fuel, dated February 13, 1997 ("Original Contract"), as amended by the First Amendment to Supply Contract for No. 2 Diesel Fuel, dated September 24, 1998 ("First Amendment" or the "Contract") with Lanai Oil Company, Inc. ("Lanai Oil").² MECO also requested commission approval to include the costs of Fuel and related taxes in MECO's ECAC to the extent that the costs are not recovered in MECO's base rates. MECO filed its Application pursuant to HAR § 6-60-6 of the commission's Standards for Electric and Gas Utility Service in the State of Hawaii.

1.

MECO's Current Fuel Arrangement With Lanai Oil

MECO states that it currently purchases and receives from Lanai Oil its entire Fuel requirement for its Lanai Power Generation Facilities at Miki Basin ("Lanai Facilities").

²The commission approved the First Amendment in Decision and Order No. 17574, filed on March 1, 2000, in Docket No. 99-0196. The commission approved the Original Contract in Decision and Order No. 15668, filed on June 25, 1997, in Docket No. 97-0047.

As described in the Application, Lanai Oil owns and operates the only large-capacity fuel terminalling facility on the island of Lanai capable of receiving fuel in bulk via inter-island petroleum tank barges. Lanai Oil also owns and operates the only inter-island liquid bulk petroleum tank barge, the "TARA", which services the island of Lanai.³ Lanai Oil purchases fuel on a free on board basis at Honolulu Harbor, where it receives the purchased fuel by pipeline in bulk into the TARA. The TARA is then towed to Lanai by a workboat.⁴

Upon arrival in Lanai, the TARA discharges the fuel through hoses into pipelines that lead directly into Lanai Oil's petroleum distribution terminal facility located at Kaunapali Harbor.⁵ Fuel is then transferred from Lanai Oil's receiving tanks through a truck loading rack into Lanai Oil's tanker trucks for delivery to MECO's Lanai Facilities. MECO takes title, custody, control, and risk of loss of the Fuel at the discharge point of Lanai Oil's tanker truck into a pipeline flange connection at MECO's Lanai Facilities.⁶

³See Application at 3.

⁴See id. at 3-4.

⁵See id. at 4.

⁶See id.

The Second Amendment

According to MECO, it began contract discussions with Lanai Oil for the Second Amendment during the first quarter of 2003.⁷ MECO affirms that its primary goal throughout the negotiations with the principals of Lanai Oil was to secure the continuation of a reliable Fuel supply to MECO's Lanai Facilities. According to MECO, however, during this time period, the principals of Lanai Oil were faced with various business and financial challenges, which slowed contract negotiations.⁸ While a contract amendment was pending, MECO and Lanai Oil had a verbal agreement to continue operating in accordance with the existing contract provisions, such that Lanai Oil continued to deliver Fuel under contract terms similar to the First Amendment. Subsequently, on December 1, 2006, MECO and Lanai Oil entered into the Second Amendment.

MECO maintains that the Second Amendment continues the contractual arrangement that the commission approved in the Original Contract, as amended by the First Amendment, whereby MECO purchases and receives from Lanai Oil MECO's entire Fuel requirement for MECO's Lanai Facilities. The key provisions of the Second Amendment are detailed below.⁹

⁷The First Amendment expired on December 31, 2003. See Application at 4-5.

⁸See Application at 5.

⁹MECO attached the Second Amendment as Exhibit I to the Application.

a.

Definitions

The definition section of the Contract was revised to add the terms "Distributed Generation Sites" and "Supplier Price Change Document." "Distributed Generation Sites" means "the locations (a) at or in the immediate vicinity of Manele Bay and (b) at or in the immediate vicinity of The Lodge at Koele, where [MECO] proposes to install distributed generation."¹⁰ MECO states that it added the term "Supplier Price Change Document" to the Contract to account for the discontinued reporting of the price of low sulfur diesel by the Lundberg Survey, which was used to calculate the "C" component of the pricing formula for Fuel under the First Amendment, as discussed further below.

b.

Extended Contract Term

The term of the Second Amendment commences upon the issuance of a decision and order by the commission authorizing the full recovery of Fuel costs incurred under the Second Amendment through MECO's ECAC, and expires on December 31, 2008. The term of the Second Amendment continues for additional successive one-year periods after December 31, 2008, unless MECO or Lanai Oil provides written notice of termination at least 180 days prior to the end of the Second Amendment, or prior to the end of any additional successive one-year period. In the Application, MECO maintains that the extended term

¹⁰Second Amendment, Exhibit I to Application, at 2.

provision in the Second Amendment provides MECO with sufficient time to pursue alternative arrangements to meet MECO's Fuel supply needs should Lanai Oil be unwilling or unable to meet MECO's Fuel supply requirements.¹¹

c.

Pricing

The price of Fuel under the Second Amendment is derived from the following amended pricing formula:

$$FP = BP + C + D + VI + E + R + T$$

Where:

- FP = Fuel price per physical gallon of Fuel purchased by MECO
- BP = Base price of \$2.465/gallon
- C = Cumulative net change in the price of No. 2 Diesel Fuel as reported by Lanai Oil and supported by Supplier Price Change Documents
- D = Price adder for delivery to Distributed Generation Sites:
 - (a) Manele Bay (or vicinity) Adder = \$0.030 per gallon
 - (b) Lodge at Koele (or vicinity) Adder = \$0.013 per gallon
- VI = Volume Incentive is a per gallon premium to reflect the ability of higher volumes supplied during a calendar year of the Second Amended Contract to cover the cost of Lanai Oil's fixed obligations. The Volume Incentive is based upon the cumulative volume of Fuel sold and delivered by Lanai Oil and purchased and received by MECO in each

¹¹See Application at 6-7.

calendar year, inclusive of the Fuel to be priced, as set forth below:

For pricing 0 - 46,000 barrels purchased in a calendar year	VI = \$0.060 per gallon
For pricing 46,001 - 47,000 barrels purchased in a calendar year	VI = \$0.050 per gallon
For pricing 47,001 - 48,000 barrels purchased in a calendar year	VI = \$0.040 per gallon
For pricing more than 48,000 barrels purchased in a calendar year	VI = \$0.00 per gallon

- E = Adjustment factor for the escalation of certain of Lanai Oil's operating costs pursuant to section 5.3 of the Contract
- R = Adjustment factor for MECO's reimbursement of Lanai Oil's certain non-routine vessel dry-docking-related costs pursuant to section 5.4 of the Contract
- T = Taxes properly assessed on the sale of Fuel pursuant to section 5.2 of the Contract

MECO states that, overall, the amended price formula is substantially the same as the price formula in the First Amendment, approved by the commission in Docket No. 99-0196. The differences between the pricing formula in the First Amendment and Second Amendment are: (1) the Base Price ("BP") was reset; (2) the cumulative net change in price ("C") component was amended to account for the fact that the index used for this component is no longer reported; and

(3) an optional price component "D" was added to account for deliveries to Distributed Generation Sites, which were not contemplated in the First Amendment.

More specifically, as to the first difference noted above, MECO explains that the BP component was reset to reflect current market prices for Fuel, as a result of the passage of time since the BP component was established in the Original Contract in 1997.¹² MECO states that, during the course of contract negotiations, MECO and Lanai Oil agreed to utilize \$2.465/gallon as the BP component for the Second Amendment, which was based on Lanai Oil's Dealer Tank Wagon price of Fuel as of September 2006.

The C component was amended because, according to MECO, the Lundberg Survey discontinued reporting Low Sulfur Diesel prices (the price reference under the First Amendment) and now instead reports prices for Ultra Low Sulfur Diesel. MECO states that, as amended, the C component will be updated monthly based on changes as reported by Lanai Oil and supported by Supplier Price Change Documents. Pursuant to the new definition of "Supplier Price Change Documents," MECO and Lanai Oil will use "the No. 2 Diesel Fuel price change notice as provided by [Lanai Oil's] fuel supplier" to adjust the "C" component of the pricing formula in the Second Amendment. MECO represents that the wholesale price changes reported by Lanai Oil's fuel supplier (i.e., Chevron) are market based, and reflect the price changes

¹²MECO notes that the BP component in the Original Contract was \$1.05, which was reflective of market prices at that time. See Application at 8.

to Chevron's wholesale price customers for gasoline and diesel petroleum products. According to MECO, MECO and Lanai Oil decided to use the price changes for High Sulfur diesel because this fuel's quality is more similar to the Fuel used by MECO's Lanai Facilities; Ultra Low Sulfur Diesel is generally used for diesel powered highway vehicles, and not for electric power generation.¹³

Regarding the "D" component of the pricing formula, MECO explains that this new component resulted from the inclusion of potential Distributed Generation Sites in the Contract. Specifically, Component "D" represents an optional delivery fee price adder that reflects an additional fee charged for the delivery of Fuel by Lanai Oil to MECO's combined heat and power project sites at Manele Bay and The Lodge at Koele. According to MECO, Fuel for MECO's Distributed Generation Sites will be purchased under the same terms used for purchasing Fuel for MECO's Lanai Facilities, but an additional delivery fee will be added to Fuel used for MECO's Distributed Generation Sites to reflect the increased time that is required to transit to and from these sites.

MECO states that, other than the amendments to the BP and C components, and the addition of the D component to the pricing formula, the other components of the formula remain essentially unchanged.¹⁴

¹³See Application at 9.

¹⁴See id. at 10.

d.

Delivery of Fuel to Distributed Generation Sites

A new section 6.3 was added to the Contract to provide the option for Fuel deliveries to the potential combined heat and power project sites at Manele Bay and The Lodge at Koele.

e.

Determination of Fuel Quality

The Second Amendment amends Section 9.2 of the Contract to specify that Fuel samples collected when the Fuel is discharged in bulk on Lanai may be taken by MECO or a MECO-approved agent. MECO explains that, previously, an independent petroleum inspector flew to Lanai for every barge discharge to obtain a Fuel sample after the barge discharged into Lanai Oil's Kaumalapau terminal. Because of reduced flights to Lanai and increased restrictions for carry-on luggage, the costs for petroleum inspector air travel and fuel handling increased.¹⁵ MECO contends that the new language in Section 9.2 allows MECO (typically an employee) or MECO's agent to obtain the Fuel sample after the barge discharges.

¹⁵See id.

B.

Consumer Advocate's Position

On May 30, 2007, the Consumer Advocate transmitted information requests ("IRs") to MECO pertaining to the Application. On June 21, 2007, MECO responded to the Consumer Advocate's IRs.

On July 6, 2007, the Consumer Advocate filed its Statement of Position ("CA's Statement of Position"), in which the Consumer Advocate stated that it does not object to commission approval of the Second Amendment. In addition, the Consumer Advocate stated that it does not object to the inclusion of Fuel costs and related taxes associated with the terms of the Second Amendment in MECO's ECAC, to the extent that such costs are not recovered by MECO in MECO's base rates.

In particular, the Consumer Advocate noted:

1. Most of the amendments in the Second Amendment are administrative in nature;¹⁶
2. The modifications to the pricing formula in the Second Amendment appear to be fair and reasonable;¹⁷
3. It appears that there are no alternate suppliers of Fuel for MECO's Lanai Facilities; thus, the Second Amendment is necessary to ensure an adequate supply of Fuel to meet the generation requirements of MECO on Lanai;¹⁸
4. In Docket Nos. 97-0047 and 99-0196, MECO investigated the possibility of using chassis-mounted petroleum tanks to transport fuel from Oahu to Lanai as

¹⁶See CA's Statement of Position at 12-13.

¹⁷See id. at 13-14.

¹⁸See id. at 15.

deck cargo on a dry freight barge, but MECO's assessment indicated that this alternative would have no material advantage over the current bulk shipment logistics, and in fact, would expose MECO and its customers to a higher level of commercial and financial risk, as well as a higher level of Fuel supply uncertainty. To the Consumer Advocate's knowledge, "there are no other viable means of fuel procurement and delivery other than the alternatives considered in Docket Nos. 99-0196 and 97-0047. In addition, the Consumer Advocate agrees that the continuation of the fuel supply arrangement with Lanai Oil is beneficial to MECO and its ratepayers because the arrangement maintains the commercial and financial risks faced by MECO while increasing the fuel supply security for the Company on Lanai."¹⁹

II.

Discussion

MECO requests commission approval of the Second Amendment, which amends, in part, MECO's supply contract for No. 2 Diesel Fuel, with Lanai Oil. Having reviewed the Original Contract, First Amendment and Second Amendment, as well as the entire record in this docket, the commission finds that the terms of the Second Amendment are reasonable and in the public interest. As noted by the commission when it approved the First Amendment in Decision and Order No. 17574, Lanai Oil owns and operates: (1) the only large-capacity fuel terminalling facility on the island of Lanai that is capable of receiving fuel in bulk via inter-island petroleum tank barges; and (2) the only inter-island petroleum tank barge in service to the island of

¹⁹Id. at 16-17.

Lanai, i.e., the TARA.²⁰ Thus, the commission finds that the Second Amendment is necessary to ensure an adequate supply of Fuel to meet the generation requirements of the island of Lanai. Moreover, the Second Amendment exposes MECO and its customers to a lower level of commercial and financial risk, and provides them with greater Fuel supply security than other investigated alternatives. Accordingly, the commission concludes that MECO's Application should be approved. MECO may include in its ECAC the costs of Fuel and related taxes incurred under the Second Amendment, to the extent that such costs are not recovered in MECO's base rates.

III.

Orders

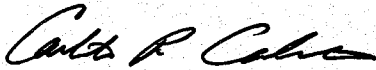
THE COMMISSION ORDERS:

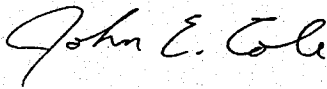
1. MECO's Second Amendment to Supply Contract for No. 2 Diesel Fuel with Lanai Oil, attached as Exhibit I to the Application, is approved.
2. MECO may include in its ECAC the costs of Fuel and related taxes incurred under the Second Amendment, to the extent that such costs are not recovered in MECO's base rates.
3. This docket is closed unless otherwise ordered by the commission.

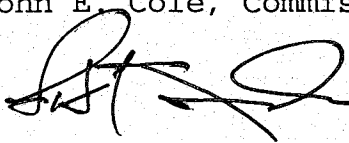
²⁰See Decision and Order No. 17574, filed on March 1, 2000, at 6.

DONE at Honolulu, Hawaii NOV 13 2007.


PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By: 
Carlito P. Caliboso, Chairman

By: 
John E. Cole, Commissioner

By: 
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:


Kaiulani Kidani Shinsato
Commission Counsel

2007-0072.eh

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served a copy of the foregoing Decision and Order No. 23829 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: NOV 13 2007